STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Assembly Bill 684	**Assembly Member Honda (As Introduced 2/23/99)**
Position:	**Support, if amended**
Proponents:	**CFT**
Opponents:	**None known**

SUMMARY

Changes the annual "2% improvement factor" applied to benefit payments from the California State Teacher's Retirement System (CalSTRS) Defined Benefit (DB) Program from a 2% simple COLA to a 2% compounded COLA. The change would be effective September 1, 2001.

HISTORY

Chapter 1305, Statutes of 1971 (AB 543--Barnes) established a 2% simple annual improvement factor, beginning September 1, 1973.

AB 2911 (Epple) of 1990 would have compounded CalSTRS' benefit improvement factor, funded through increased employer contributions, but failed passage in the Assembly Ways and Means Committee.

SB 2016 (O'Connell) of 1995 would have compounded the 2% improvement factor. SB 2016 was held in Senate Appropriations Committee.

AB 884 (Honda) of 1997, identical to this bill, was held in Senate Appropriations Committee. The Teachers' Retirement Board adopted a Support if amended position to identify a funding source.

CURRENT PRACTICE

Under current law, the CalSTRS DB Program benefit payments are increased by a 2% improvement factor each year beginning on September 1 following the first anniversary of the effective date of the benefit. The factor, however, is not compounded. (In contrast, CalPERS adjusts allowances by up to 2% annually, and that increase is compounded.)

DISCUSSION

CalSTRS' current 2% simple benefit improvement factor generally has not kept pace with inflation over the years. Retired members and other benefit recipients, however, receive supplemental payments when their allowance has eroded to 75% of the purchasing power of the original allowance. This is currently 18 years after retirement, based on recent inflation experience. The compounded improvement factor proposed by AB 684 would be applied beginning September 1, 2001, to all current and future benefits payable and would provide improved protection against inflation for benefit recipients not receiving purchasing power payments.

FISCAL IMPACT

Benefit Program - Currently there are an estimated 151,000 individuals receiving benefits from the System's DB Program. The vast majority of these recipients receive an annual 2% improvement factor.

The estimated additional costs in current dollars for compounding the 2% improvement factor would be over $2.8 billion over 30 years. Financing these costs over that time period would require increased contributions equal to 1.107% of payroll. This is projected to be equivalent to $195 million in increased annual contributions initially and will increase annually as payrolls increase. AB 684 does not provide funding for the increased cost of compounding the improvement factor.

This cost would be partially offset by a decrease in the amount of supplemental payments paid from the Supplemental Benefit Maintenance Account because fewer benefit recipients would have allowances with purchasing power below 75%. The present value of this reduction is $1.3 billion. Because purchasing power payments are paid from a different source, however, these offsetting savings would not affect the impact of the compounded COLA on the Teachers' Retirement Fund. The savings in the supplemental payments would, however, extend the amount of time that the funding for supplemental payments is sufficient to maintain 75% purchasing power.

Administrative - There would be one-time administrative costs for implementing this legislation of approximately $190,000 including development, testing and implementation of modifications to the automated system, updating procedures, and revisions to member communications.

POSITION

The Board voted to support AB 684, if it is amended to identify a funding source to pay increased program benefit costs. If amended, the bill would provide for a funded increase in the permanent benefit maintenance for retired members and other benefit recipients who receive payments from the STRS DB Plan. Funding sources would include increased employer contributions or surplus earnings within the guiding principles adopted by the Board at the June 3 board meeting.